

July 21, 2010

Pakistan Market**LOTPTA: Regulatory risk materializes – ‘Sell’****MORNING BRIEFING**

KSE100 Index: Closing 10251.53 ↑ (+49.68)

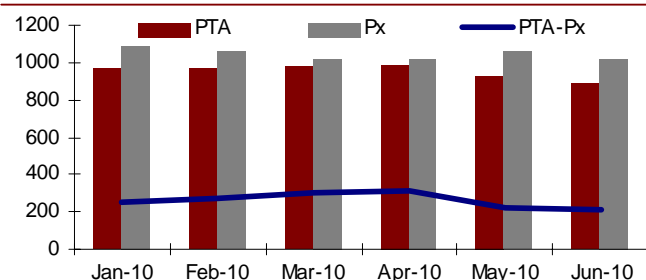
The Economic Coordination Committee (ECC) in its meeting yesterday finally decided to slash duty on Purified Terephthalic Acid (PTA) from 7.5% to 3% and concomitantly increased duty on Polyester Staple Fiber (PSF) by 1.5% to 6%. We believe, this bodes negative for LOTPTA as margins will squeeze, going forward. Post this development, we have revised down our earnings estimate for the company, and recommend ‘Sell’ on LOTPTA.

PTA duty cut to reduce earnings

In response to previous withdrawal of the monetization incentive, the ECC has reduced duty protection on PTA to 3% from 7.5% earlier. While this would be positive for the PSF chain, it would prove to be negative for LOTPTA. For 2010, the impact would be realized in the second half of the year, eroding 2010 earnings to Rs1.61 per share compared to the previous estimate of Rs1.96. However, the full impact of the same would be taken in account from 2011 onwards, driving EPS down by Rs0.72 to Rs1.02 in 2011.

Primary margins to erode by US\$53

After touching a high of US\$315 in April 2010, average primary margins (PTA-Px) witnessed a declining trend in 2Q2010 and fell to US\$217 in June 2010. Going forward, margins would remain under pressure due to expected regional capacity additions.

PTA primary margins (US\$ per ton)

Source: JS Research

Moreover, with the reduction in the duty protection tariff, we believe the company’s primary margins would erode by US\$53, assuming to keep prices constant at 2Q levels.

PSF duty increased to 6%

Along with a duty cut on PTA, ECC in its meeting has also decided to increase import duty on PSF from 4.5% to 6%. The change in duty structure is likely to significantly mitigate the negative impact of earlier de-monetization of PTA for the PSF manufacturers like ICI Pakistan (ICI) and Ibrahim Fibres (IBFL). Hence, we expect the revision in duty regime to have a cumulative neutral impact on PSF companies.

Recommendation: ‘Sell’ LOTPTA; ‘Buy’ ICI

We recommend investors to ‘Sell’ LOTPTA, where as we have a ‘Buy’ stance on ICI which currently trades at a discount of 24% to our target price of Rs160.

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Also in focus**Extension sought on RD on yarn exports**

The Senate Standing Committee for textile has sought for a one month extension (till August 26, 2010) from the government on the Regulatory Duty (RD) on export of yarn. However, given the better cotton outlook along with cotton prices cooling down, we believe the extension is likely to be turned down by the government. The RD is due to expire on July 26, 2010 which will definitely bode well for the standalone spinners.

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